Restaurant Business

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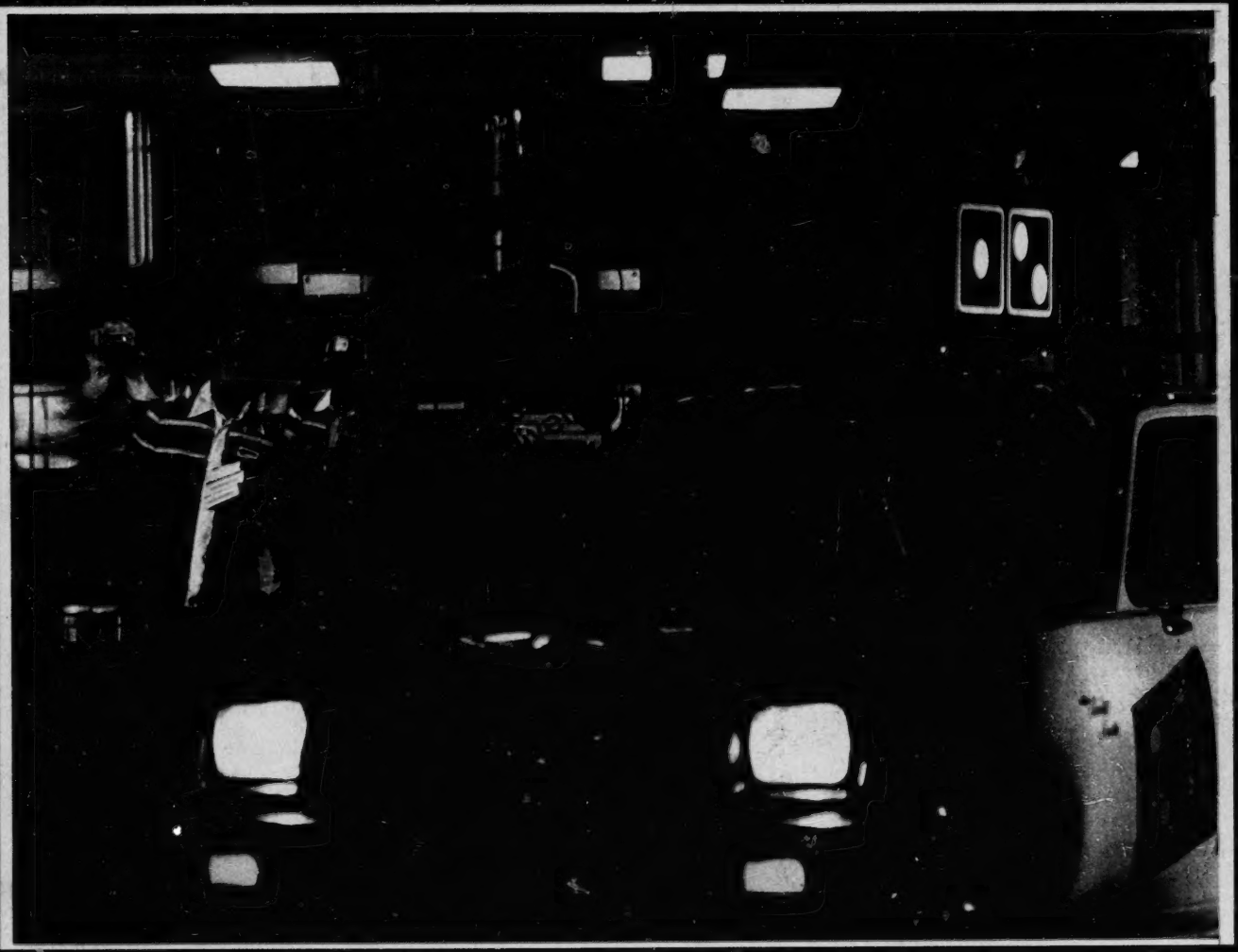

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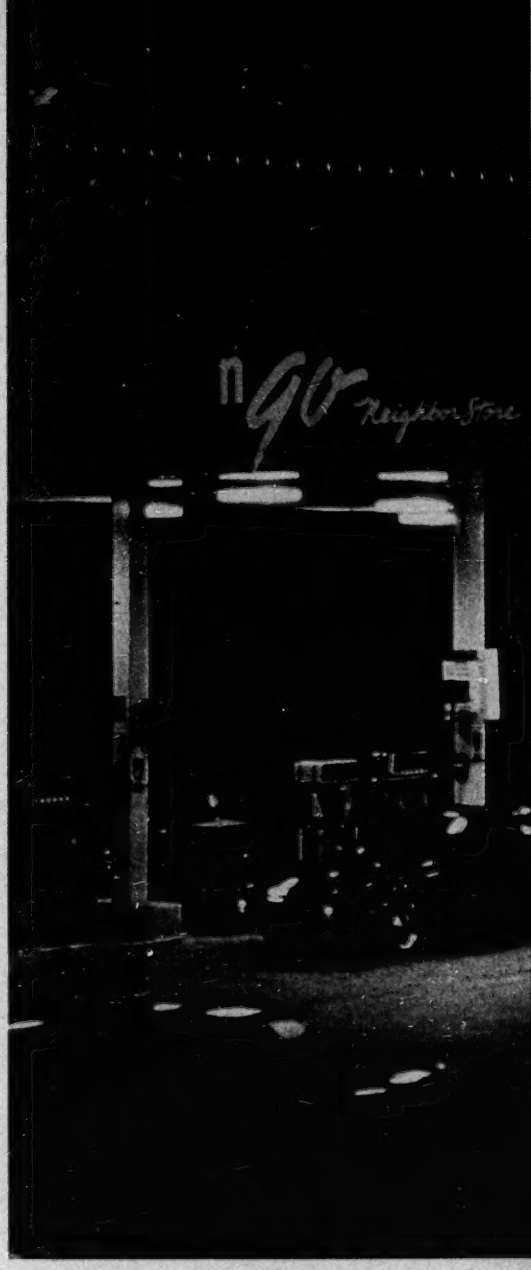
CONVENIENCE STORES:

HOW BIG THE THREAT?

For years, the fast food industry has been warned that convenience stores, with their numerous locations, were poised to take market share away from the quick service giants. But—so far at least—these dire warnings haven't come true.

By Ralph Raffio



Convenience store executives like to make plenty of claims about how they're cutting into fast food's share of the eating-away-from-home market. But exactly what impact they are having and the outlook for the future is clouded. Are convenience stores the threat some make them out to be?

Convienence stores—known as c-stores—have no doubt made substantial headway into fast food in recent years, mostly by just expanding their menu offerings. But, according to many foodservice industry experts—and even some c-store executives—the industry has still got a long way to go before being able to effectively compete with fast food.

In 1984, c-stores managed to rally a total of $3 billion in fast food sales, according to the National Association of Convenience Stores (NACS), Falls Church, VA. There's been excitement over that in the industry because those sales represent a $600 million increase over the previous year on items which contribute better margins than anything else c-stores sell. Sales in 1985 are estimated at about $3.2 billion.

By contrast, sales gains among fast food restaurants in 1985 totaled more than the whole of fast food sales among c-stores for the year, up $4.4 billion over 1984. Total fast food restaurant sales in 1985 reached $47 billion, up from 1984's $43.7 billion.

With sales figures so commandingly unbalanced in favor of fast food, just what is it that makes c-stores a force to reckon with? Industry experts say it clearly isn't their ability to command a large portion of total fast food sales in years to come. Neither, they say, is it an ability to be better at providing quality food quickly to patrons, nor the creation of new customers that only c-stores can service effectively.

Instead, the threat c-stores pose to fast food, say most onlookers, is more annoying than that. C-stores represent yet another faction chipping away at what is already a viciously competitive fast food market by offering quick-stop shopping for the ultimate convenience-conscious consumer. By doing that, c-stores are hoping to carve out a niche for themselves—by stealing a portion of fast food's customers—at the expense of more powerful restaurant chains whose products may be superior in terms of quality. In other words, a saturated fast food industry doesn't need another kid on the block stirring up trouble, which is precisely what c-stores are doing.

While convenience stores offer advantages to consumers, they are sometimes faulted on food quality. Stop N Go (above) has over 1,000 locations.

Denny Lynch, a vice president at Wendy's International of Dublin, OH, discounts the c-store threat: "Anyone who can expand the market is a positive force," he says. "But I haven't seen any evidence that they are expanding the market. If they can't do that, they'll have to out-hustle us." And out-hustling an industry that markets the way the fast feeders do is difficult.

QUESTIONS WITHOUT ANSWERS. But the major point of disagreement concerns how much muscle c-stores have to flex. In competing with the fast food industry on its turf, convenience stores are going up against a competitor whose level of sophistication is far greater in both foodservice operations and in marketing. To be sure, there's also some question about whether or not c-stores are indeed stealing from fast food at all. Opinions on this vary.

"Fast food says it's not having a problem, we say we're not having a problem, but there's a few billion dollars coming out of somebody's pocket," says David Bixler, president of Denny's Restaurant Division, La Mirada, CA. "I think convenience stores are taking it out of fast food."

Bixler says c-stores are more likey to find success at breakfast than any other daypart. "There may be some opportunities for c-stores in snacks or light

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Says Denny Lynch, a vice president at Wendy's: 'Anyone who can expand the market is a positive force. But I haven't seen evidence that c-stores are doing that. If they don't, they'll just have to try to out-hustle us."

C—STORES, *continued from page 127*
lunches, but I think that would only be moderately successful," says Denny's restaurant chief. "Beyond that, the quality of c-stores' foodservice becomes a problem. But at breakfast, there are a lot of people who only want a cup of coffee, a roll, and be on their way. You don't have to be McDonald's to do a good job at that."

But not eveyone agrees that c-stores will make inroads with their fast food programs. Says one executive with a leading Southwestern fast food chain: "C-stores have wrestled with the fact that they'd like to do fast food, but they haven't had the discipline to effectively compete so far."

The strength of convenience stores' fast food programs is indeed largely centered around quick breakfast items like coffee and danish, and sandwiches during other times of the day and evening. In essence, they're selling convenience more than they are food, which is where the controversy starts.

"C-stores sell convenience first, food second," says Charles Glovsky, senior securities analyst with Alex. Brown & Sons, Baltimore. "Fast food chains approach it the other way around, and that, I think, gives them the edge."

Not that c-stores think they can rob fast food chains of great slices of their market. C-store executives don't claim to be eyeing a head-on battle with fast food, just a noticeable raid on a portion of consumers—light users of breakfast, for instance, as well as snack customers. But even those small shares of a huge market are meaningful. The industry relies, after all, on impulse purchasing, and isn't likely to change much. And, though some shifting has occurred, c-stores' customer base remains dominated by blue collar males.

ONLY PRIME SPOTS. One thing c-stores have in their favor, however, is a huge number of stores. Though store development has steadily declined in recent years, there should be around 60,000 c-stores operating by year-end. That's about half the amount of fast food outlets open, but presents a formidable competitor nonetheless.

Even though unit growth has slowed industrywide, largely as a result of consolidation among companies, c-stores being built today are only located in prime locations. Companies are only developing what are known in the industry as "A" locations, short for corner sites in high traffic areas. Many other stores are being closed, for instance, in favor of developing "A" locations, witnessed by industry leader Southland Corp., owner of 7-Eleven. Dallas-based Southland totaled 7,519 7-Eleven stores by year-end 1985, a surplus of only 46 stores over the previous year. The company opened 385 stores last year, including 67 that were relocated to corner sites. The company closed 166 store last year, and sold off 106 others.

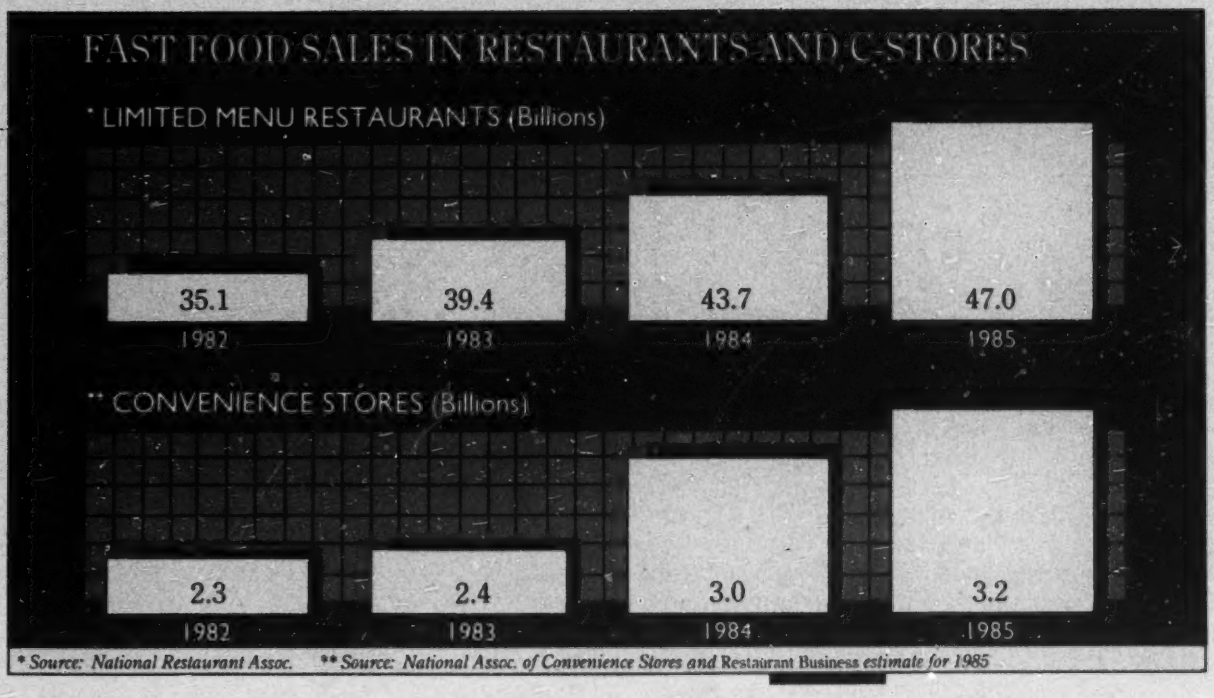
Circle K Corp., based in Phoenix, is the second largest c-store chain in the country with 3,400 units nationwide, and it too will develop only "A" locations from now on. Senior vice president, foodservice division, Steven Schwitalla, says location is the industry's key strength.

"In this respect we've got definite advantages over fast food," Schwitalla explains. "Fast feeders depend on top-of-mind awareness. We achieve that with our locations. They're highly visible."

But consumer awareness of c-stores—at least right now—has little to do with their talents at offering foodservice. Fast food is only a small portion of what c-store sell—accounting for under 10 percent of sales industrywide, according to the NACS—so it's often not given the attention at the corporate level or the marketing dollars it requires to make a greater impact. C-stores are far better known for their gasoline, groceries, and cigarettes than for fast food.

"It's true that our awareness is not now related to fast food, but that can change," says Schwitalla. "As an industry, we haven't done a very good job telling our customers what we have available in fast food. What's changing, though, is that the industry is becoming more sophisticated. We know now that we must approach the business aggressively if we're to be successful at fast food."

Which brings the conversation around to marketing, an area where fast food chains are clearly in command by virtue of the dollars they spend. Add to that the fact that c-



stores have other things to sell besides fast food, and the scale tips even further.

"C-stores just aren't as focused as fast food," says Roger Lipton, managing director of Lipton Research, a division of Ladenburg Thalmann & Co. Inc., New York City. "They're trying to be all things to all people."

C-store executives say the key to their marketing approach must be different than fast food's. "I think it would be unwise for us to take on the big fast food guys head on," says Corwin J. (Jim) Lynch, Jr., director of fast foods, National Convenience Stores Inc., Houston. "We need to use a different marketing approach. Someone going for a hamburger at lunchtime isn't going to think of a c-store. But if a person is looking for a bite to eat at three in the afternoon, we can get them. The key to marketing for c-stores is selling convenience."

Lynch says c-stores rely heavily on one-stop shopping. Gasoline is available in a majority of c-stores nationally, automatic teller machines (ATMs) are catching on fast, and so are video rentals. "We have the ability to do cross-tie promotions where fast food cannot," says Lynch. "That may not go as far as the hundreds of millions of dollars fast food spends on marketing but we think it's meaningful."

"C-stores have historically been used for quick stop, emergency purchases, and that presents a marketing problem," says Martin Venturini, vice president, marketing, Convenience Food Mart, Rosemont, IL. "It's not easy getting to the top of consumers' minds when fast food pumps so many dollars into marketing."

'C-stores have wrestled with the fact that they would like to do fast food, but they haven't had the discipline to effectively compete so far,' says one executive with a Southwestern fast food chain.

Instead, CFM relies on in-store marketing to promote fast food, making a strong visual impression on consumers entering the store by upgrading the fast food area. In order to gain awareness among its consumers, NCS now relies on giving away free coffee. Each day a window sign tells passersby whether or not coffee is free that day. "It gets people looking at the stores," says Lynch. "That's important for us."

Circle K's Schwitalla admits that fast food's marketing power presents a problem for c-stores, but explains that Cirle K is prepared to "fight it out in the trenches" with fast food. Along with a $140 million remodeling program—of which 60 percent has been allocated to upgrading foodservice areas—Circle K is pouring half its ad dollars this year into promoting foodservice. The company will also begin network television advertising.

PROFIT POTENTIAL. Put in perspective, there's good reason for c-stores to go after the fast food customer in whatever way they can. There's a lot more profit in fast food than there is in any product category c-stores participate in. According to the NACS, gross margins for non-gasoline products industrywide are about 32 percent, while gross margins for gasoline are only 6 percent. Averaged out, that's a total gross margin of under 22 percent.

Fast food's margins are much better, though. According to c-store executives, margins for fast food items range between 40 and 70 percent, the high being for soft drinks. On average,

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'Its true that our awareness is not now related to fast food,' says Schwitalla of Circle K. 'But we know now that we must approach the business more aggressively to succeed.'

C-STORES, *continued from page 131*
fast food programs among c-store chains frequently average out at about 45 percent gross margins.

That being the case, it's easy to understand why c-stores have targeted fast food to bolster sales and profits. Industrywide, c-stores profits were on a slide in both 1982 and 1983, showing some gains since then. But, say many onlookers, it takes a lot to make a fast food program work than better margins, and c-stores have had their share of problems making the grade. Specifically, quality hasn't been nearly on par with fast food chains.

"There's one thing c-stores don't do, and that's throw away food," says one fast food executive. "And if you're going to be successful in this business you have to be prepared to do that. That takes discipline, and I haven't seen a c-store demonstrate that sort of discipline yet."

Circle K's Schwitalla admits this has been a problem. "That's absolutely true," he says. "As an industry, we've got a retailer mentality. Waste comes right off the bottom line, and is therefore not a viable cost of doing business. We have to adapt to a foodservice mentality where waste is just another cost of doing business."

But Schwitalla also defends the industry for the sheer fact that it is different and should not be directly compared with fast food restaurant chains.

"C-store fast food is different from traditional fast food, and that's where the quality issue becomes confused," says Schwitalla. "Items are different, for one thing. We're in the sandwich business, not in the hamburger or fried chicken business. We appeal to the consumer in a different way. Quality is still a big issue, but it isn't the issue it was five years ago."

Though the industry places high priority on bolstering fast food sales, few c-stores look to do so by offering similar products to the major fast food segments. Fried chicken, hamburgers and pizza have been tried by some c-store chains, even with some success, but such items are insignificant in the larger picture.

MENU DIFFERENCES. If there's one area where c-stores can build a following, it would be fresh deli sandwiches. And most chains have already found that out. Like most c-stores, Circle K refrains from competing head-on with fast food in its products, instead relying on being different in terms of menu and convenience. The company introduced a line of freshly made low-calorie sandwiches last year priced at around $1.49, as well as a 10-oz. pizza burrito selling for $1.69.

"It's a matter of finding unique niches that aren't competitive with fast food," says Schwitalla. "That's the way to succeed in this business." Schwitalla claims that within the next few years, Circle K will be a major distributor of hot dogs—again, a product not directly competing with fast food chains.

Proving that point, at 7-Eleven stores it isn't hamburgers but hot dogs that are a big seller, an item which has eluded dominance by fast food chains on a national scale. Nachos and freshly prepared deli sandwiches have also shown promise at 7-Eleven.

National Convenience Stores, with 1,000 units open and 51 under construction, is also steering clear of fast food's burger, chicken and fish fare. Instead, NCS is targeting service delis as well. The c-store chain now has 100 delis operating with plans to expand the program gradually. A new "Hex" store—named for its hexagonal shape—has been developed for corner locations, and is expected to help boost fast food sales by allocating more space and upgraded facilities to foodservice.

"I've been given as much space for fast food as I need," says NCS's Jim Lynch. The company's fast food director claims that, within three to five years, fast food will comprise 20 percent of total square footage among NCS stores, no small factor when Hex stores are tagged for 3,100 sq. ft. of total floor space each. Some of NCS's stores offer hot breakfast sandwiches as well, such as eggs and cheese on muffins or biscuits.

Convenience Food Mart, with 1,300 stores, is also eyeing higher fast food sales. The chain is currently rolling out a line of "Deli Supreme Sandwiches" which are available with five special sauces. CFM's marketing vice president, Martin Venturini, says the spe-

Circle K will spend about $80 million to upgrade foodservice to this concept.

Convenient Food Mart offers a package including sandwich, drink, and chips.

cial sauces are the key to the new deli program. "The sauces are made exclusively for us," says Venturini. "It's like Burger King's Whopper or McDonald's Big Mac. It's important to offer your customer something that's uniquely your own."

CFM recently played off another fast food marketing ploy. The chain's "Movin' Meal"—à la McDonald's Value Pack—includes a sandwich, soft drink and chips in a box designed for traveling. "It's important to offer something that can be eaten in the car," says Venturini. "Take-out is a key part of this business."

In the long run, though, Circle K's Schwitalla doesn't think c-stores will noticeably cut into fast food's crucial drive-thru business. "A significant portion of c-store sales are impulse sales, which means we depend on getting customers into our stores," explains Schwitalla. "Drive-thru sales are a pre-determined situation because the customer can't see anything when he orders. In that sense, we don't think we can pull business from fast food's drive-thru sales."

NO WORRIES. With fresh delis cropping up all over the c-store universe, it would be logical for sandwich chains to be worried.

Not so, according to Fred DeLuca, general manager of Subway Sandwiches & Salads: "It's important to us that a lot of people get into the habit of eating sandwiches," says DeLuca. "With all those c-stores offering sandwiches now, it will increase our segment's share of the total fast food market. We see it as a big plus for the sandwich shop business." Based in Milford, CT, Subway is the nation's largest sandwich shop chain with 600-plus units. According to DeLuca, Subway sales are running 12 percent ahead of last year.

'C-stores just aren't as focused on fast food,' says securities analyst Lipton of Lipton Research, a division of Ladenburg, Thalmann & Co. 'They're too busy trying to be all things to all people.'

Though c-store and fast food executives remain closemouthed about the possibility of teaming up in the future, some industry onlookers think this will be an emerging trend.

On the West Coast, Winchell's Donut House, a Denny's subsidiary of over 700 units, recently teamed up with Atlantic Richfield Co.'s am/pm c-stores. Winchell's donuts are now in test at some am/pm stores in Los Angeles, though the company hopes to place itself in 250 stores sometime down the road.

Hardee's Food Systems Inc., of Rocky Mount, NC, the fourth largest hamburger chain, recently signed a licensing agreement with 7-eleven. A test begins this month.

"We've talked to c-store companies, and we'd like to try something this year," says Robert M. Rosenberg, chairman and chief executive officer, Dunkin' Donuts Inc., Randolph, MA.

Rosenberg adds that over 100 Dunkin' Donuts franchisees now supply c-stores, though the products are unbranded.

"I don't think that's the best way to do it," Rosenberg adds. "If you have a name brand you should use it."

"Fast food chains can bring a discipline to c-stores as well as a national flag to run up their mast," says one fast food executive. "I think you'll probably see some teaming up occurring. It's very much like when fast food chains started hitting the turnpikes. Those were untraditional locations that offered some real opportunity, and so are c-stores."

Circle K's Schwitalla says he's talked to fast food chains about teaming up already, including McDonald's. "At this stage, all we're doing is talking," he says. ■

THE TAX BITE

BY IRVING BLACKMAN

PLAYING AUDIT ROULETTE WITH THE IRS

The game goes on. You file; the IRS examines. During 1985 a total of 1.26 million individual income tax returns were subjected to the displeasure of an IRS audit. Overall, this means that 131 returns out of 10,000 filed were examined in 1985; up a bit over the 124 per 10,000 in 1984.

But don't get overconfident that these low percentages apply to you. The higher your income, the greater the interest the IRS has in paying you a visit.

To give you an idea of the massive task the IRS has each year in tracking down tax cheats, the Service received 96.5 million individual returns in 1985, plus millions more of corporation, partnership, and trust returns.

The chances of having your business or company audited decreased dramatically in 1985, compared to 1984, especially for smaller corporations. However, your chances of hosting an examining agent in 1985 increased if you operated a larger business.

And to each reader who ends up facing the dangers of an IRS tax audit, good luck!

CHANCES OF BEING AUDITED

Total Personal Income	Chances in 10,000
$10,000 to $25,000 (no itemized deductions)	167
$10,000 to $25,000 (inc. itemized deductions)	64
$25,000 to $50,000	202
$50,000 and over	353

Non-Corporate Business (Income—Schedule C)	Chances in 10,000 1985	1984
Under $25,000	145	143
$25,000to $100,000	255	256
$100,000 and over	540	530

Corporations (in assets)	Chances in 10,000 1985	1984
Under $100,000	93	112
$100,000 to $1 mil.	174	259
$1 mil. to $10 mil.	689	930
$10 mil. to $100 mil.	2,976	2,527
$100 mil. and over	8,629	7,095

DIVORCE CAN BE A TAXING SITUATION

One of the sad (or happy, for some) facts of American life these days is the high divorce rate. As if the mental and emotional turmoil weren't enough to handle, divorce has some sharp tax points that are capable of inflicting additional pain. Many of these tax points deal with the new alimony rules that became effective for divorce agreements signed after 1984.

Let's take a look at some of the new alimony rules. First, the payments must be in cash; a transfer of property, such as a house, stocks or bonds, does not qualify as alimony. Next, the payments must be paid (and received) according to a divorce or separation agreement. Warning: If the agreement states that the payments are nondeductible (or nontaxable), they do not qualify for alimony for tax purposes. Now, the most important no-exception rule: If the alimony is deductible by the paying spouse, it is taxable to the receiving spouse.

Another rule involves the divorcing parties' children. Suppose that an agreement specifies that payments will be reduced by a fixed amount after an event that relates to a child (for example, the child marries or turns 21). The reduction amount is treated as child support and is not deductible alimony.

The person paying the alimony and the person receiving it must not be members of the same household, except in very limited situations. This new wrinkle was passed because Congress felt that the courts were getting too liberal in allowing alimony between ex-spouses who continued to live under the same roof due to economic circumstances.

Two major changes in the alimony rules deal with payments that total over $10,000 per year: the minimum-term rule and the front-end loading rule. Under the minimum-term rule, if payments exceed $10,000 in any one year, the excess is not deductible alimony, unless some payments are made in each year for at least six years immediately following the divorce. However, even if the rule is broken, the first $10,000 of payments in each year is deductible.

The front-end loading rules are a complex nightmare. If alimony payments in a particular year decrease by more than $10,000 from the prior year, a to-be-computed difference is not alimony at all, but a new tax creature called "alimony recapture amount." You won't believe the result: This amount becomes income to the ex-spouse who originally deducted it and a deduction to the ex-spouse who originally included it as income. The calculation must be made every year. Fortunately, the rule does not always apply—for example, where payments are being made under a temporary agreement, if the agreement allows fluctuating payments, or the recipient has remarried.

The author, an attorney and CPA, is senior partner at Blackman, Kallick and Co., Chicago, and author of "Winning at the Tax Game."

TIME TO AMEND YOUR PROFIT SHARING PLAN

This article is a warning and a necessary reading if you have a qualified plan. The IRS is on the warpath. Your qualified plan must be brought into compliance with a host of new

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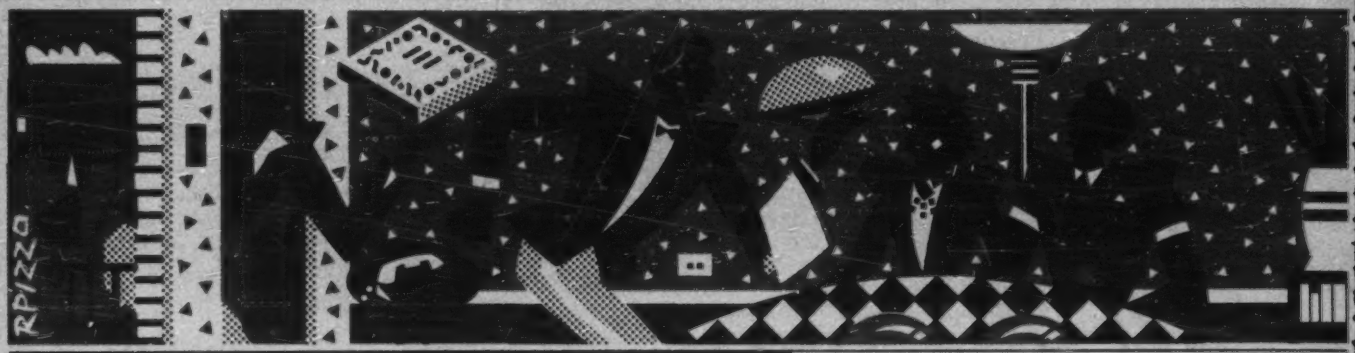
ILLUSTRATIONS BY ROBERT PIZZO

TAPPING THE AT-HOME MARKET

The potential market for food prepared on premise for consumption off premise—take-out and delivery—is getting truly enormous.

Home is where the heart of an important new sociological trend lies, and savvy foodservice entrepreneurs are taking advantage of the business possibilities that supplying fully prepared foods to the at-home consumer represent. Take-out and home delivery are enjoying increasing demand as more Americans enjoy the fruits of their labor at home, but like any new venture, the at-home market must be carefully considered. Packaging, distribution, and quality control are just some of the questions that must be answered in order to tap the lucrative at-home market. Fast food outlets with drive-thru windows are already positioned to offer take-out, but there are opportunities for other segments as well. And while Domino's took an early lead in delivery, the field is wide open.

BY SARAH PERSON



The growing popularity of VCRs and other stay-at-home forms of entertainment, coupled with a demand for convenience, spells opportunity for take-out and delivered foods.

It's a typical Tuesday evening, and Mr. and Mrs. Baby Boomer and their two children are gathered in the living room, pondering over which rented videocassette movie they should watch on their VCR. The question of dinner has come up, but the answer is an easy one—they're going to have it delivered to their home.

The question of what to have for dinner is an old one, of course, but the answers that today's fast-paced, convenience-seeking consumers are coming up with are new, with dramatic implications for the foodservice industry. Rather than buying food at the supermarket to cook at home, people are choosing, with increasing frequency, to take home already-prepared foods and serve them for dinner, or order into the home via home delivery. And the potential sources for that Tuesday evening dinner are no longer simply a fast food or family-style restaurant: They are as varied as the local white tablecloth restaurant, gourmet food store, employee cafeteria, supermarket, convenience store, or any one of a number of places that have begun catering to the at-home market.

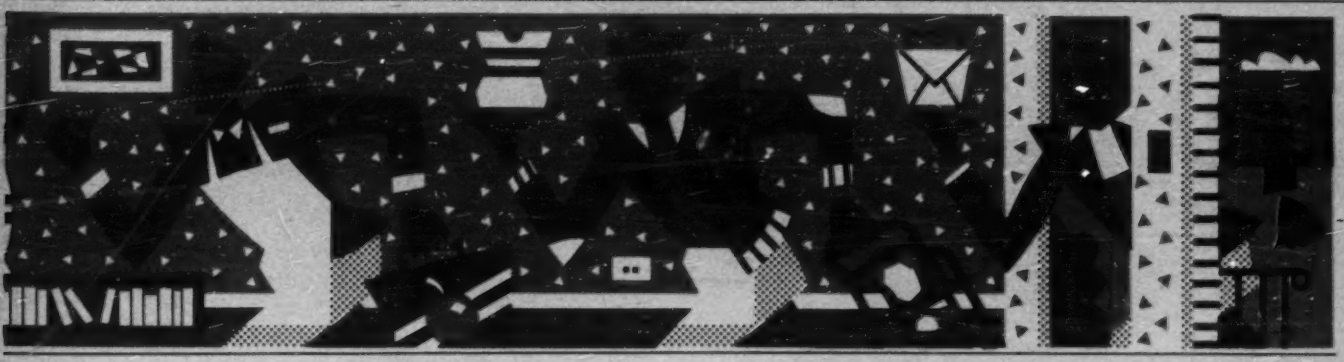
THERE'S NO PLACE LIKE HOME. Tapping this potentially lucrative at-home market is the future for the restaurant industry, according to industry analysts. Restaurants typically achieve success by offering quality food and service at a price which represents some degree of value to the consumer. But the American home can also provide that, and more—comfortable surroundings, pleasant ambience, entertainment, and most importantly, superior price/value. It is also far more convenient to stay at home, and more predictable.

"The consumer has experienced the restaurant market during a period of 15 to 20 years of saturation, in the broadest range of restaurants, and he knows what's out there," explains George Rice, president and CEO, GDR/CREST Enterprises, part of the NPD Group of Companies based near Chicago. "He knows what to expect and how to differentiate quality, and now he has a choice and the wherewithal to make it. This consumer has no qualms about staying home."

Rice and other market researchers maintain that there is a broad shift in society's attitude about the home. "The home is viewed as a refuge from the daily pressures of life," maintains William C. Hale, senior vice president, Agribusiness Associates Inc., a management consulting firm based in Wellesley Hills, MA. "Consumers are spending their hard-earned money to make home even more comfortable, a haven from all the pressures of a modern, fast-paced lifestyle."

Home entertainment, in the truest sense of the word, has become a part of daily life, encouraging a stay-at-home attitude. Cable industry analyst Paul Kagan, founder of Paul Kagan Associates, Monterey, CA, predicts that 70 percent of American households—a total of 70 million of them—will own VCRs by 1990; 29 percent of all households already have VCRs today, versus just three percent five years ago. At the same time, VCR tape rentals have skyrocketed into a multibillion dollar industry, and projections suggest that this will continue. Meanwhile, according to the Motion Picture Association, attendance in movie theaters declined by 12 percent in 1985.

Furthermore, the microwave is making eating at home more convenient.



By the end of 1986, market penetration for microwave ovens is projected to hit nearly 61 percent of all households, with 53.8 million ovens in use, according to one manufacturer.

Taking into account these trends, Agribusiness Associates predicts that by 1990, 25 percent of all meals eaten in the home will be purchased fully prepared, creating a tremendous new window of opportunity within the industry. These meals will either be purchased as take-out food, or delivered to the home.

Fast food outlets with drive-thru windows are already well positioned to meet the demand for take-out food and delivery is available through a handful of purveyors—notably Domino's Pizza and the local Chinese restaurant—but the sophisticated, always price-conscious consumer is becoming increasingly interested in variety in the food he eats—at home as well as away. According to George Rice, Bill Hale, and others, the savvy entrepreneur will start to focus his attention on how he might best capture a portion of this market for food prepared on premise for consumption off.

Though the road to the at-home market is paved with potholes—among them problems in speed of delivery, customer satisfaction, methods of distribution, and packaging—it is also a road paved with potential profits, as Ann Arbor, MI-based Domino's Pizza has demonstrated. With over 3,000 units, Domino's is the acknowledged leader in home delivery, and has put the pizza business on the at-home map, but the opportunities abound for all types of take-out/delivery food outlets, and the time to get in is soon.

Observes Bill Hale: "The consumer's thinking is 'do I want to eat out tonight or eat home?' If he decides to stay home, a restaurant with a take-out or delivery option stands a chance of getting that consumer."

DELIVERY FEVER. Thus far, the delivery-only market has been dominated by the pizza segment, notably Domino's, but the delivery business—especially for pizza—is beginning to swell rapidly.

Pizza Hut has begun home delivery, with about 800 delivery-only units scheduled to be in place by the end of 1986. Larger markets will be served by Central Order Taking Stations (COTS), which can be reached from anywhere in a city by dialing one number, and which automatically direct the order to the closest unit. Bloomington, IN-based Noble Roman's has begun offering pizza delivery—called Mobile Roman's—in eight markets. Little Caesar, with about 1,000 units, has also built its business on carry-out.

But Domino's remains, thus far, the benchmark, unequaled in home delivery. How do they do it?

"One of the big factors in our success is that we have kept the menu simple," maintains Domino's regional vice president David Smith. "We offer pizza and only one beverage. That way, we are able to focus on one concept: delivering our product within 30 minutes. We are consistently advancing the technology of our ovens, and are always looking for ways to shave seconds off the process. We've got it down to 60 seconds from order to oven, and every step of the way, we pride ourselves on an in-store urgency to get that pizza delivered within the promised time frame. Eighty percent of the business comes in during 20 percent of operational hours, from dinner to 9 P.M., and we spend a lot of time preparing for that rush so that we can keep our part of the bargain." Smith stresses what operators getting into home delivery should always remember: "The job of getting the product out in thirty minutes is accomplished in the store, not on the delivery route."

In addition, Domino's is testing a one-number central ordering system in about 10 to 15 markets to speed up delivery from the closest unit. Because the system transfers orders to the appropriate unit via computer, it elimi-

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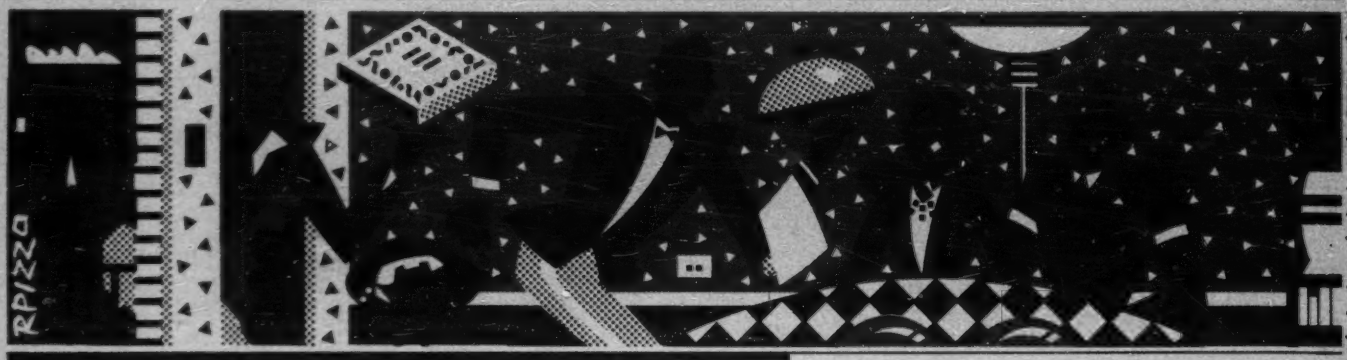
John B. Polcari & Sons, a restaurant/groceria located in Boston, counts approximately 20 percent of its sales from retail and take-out business. Sophisticated menus and merchandising attract a target market of affluent young professionals.



Proper packaging and merchandising of foods, as well as strategic location of outlets, are important considerations for success when developing take-out.

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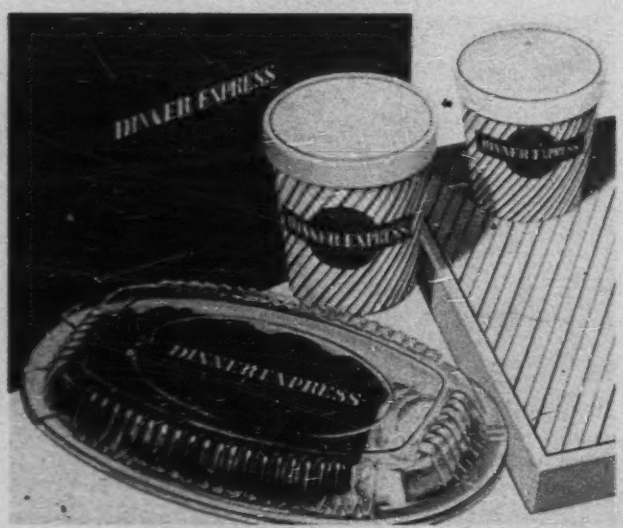
nates, providing a cost-cutting factor in addition to saving time.

Market studies have shown that consumers are willing to purchase a wide variety of items for home consumption. Tony Roma's, a barbecue chain out of Dallas, has been doing home delivery out of 42 existing units for the past year, and according to William E. Eskew, vice president, marketing, has had "substantial, incremental increases in sales. We saw it as a basic opportunity to satisfy consumers' needs for convenience."

Roma's home delivery service offers the basic Tony Roma's menu, and items are supplied from the same kitchens which service the restaurants, which can often cause logistical problems if the dinner rush hits both dining room and delivery service at the same time. The company is looking into adding additional broiler/fryer capacity in existing units to solve this problem. Items are packaged in insulated packaging, and delivered to the home by car. "Getting the food there within half an hour is an ongoing challenge that we face," explains Eskew, as it is for many foodservice operators jumping on the home delivery bandwagon. The company also checks back with customers to assess satisfaction. Feedback on the speed of delivery and service is essential for any operation in home delivery.

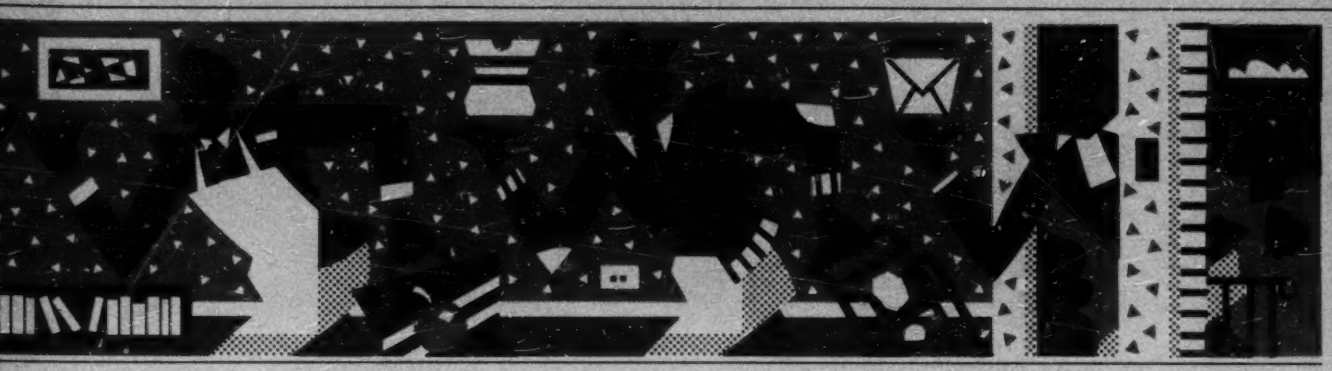


ARA Services' Dinner Express take-out program is aided by a well-developed packaging and marketing concept. The program accounts for as much as 10 to 15 percent of sales per unit and is in approximately 60 of ARA's contract locations nationwide.

DEDICATED FOR PROFITS. The potential for profits in take-out has already been widely demonstrated by the chains' success with the drive-thru window (which accounts for as much as 50 percent of sales on a general, industrywide basis). But the real profits in exploiting the at-home market, as evidenced by the outstanding success of Domino's, is realized in dedicated, stand-alone home delivery and take-out units. Costs of installation, operation, and labor are reduced in comparison with units specializing in on-premise dining, thereby increasing profit margins.

Agribusiness Associates prepared comparative investment and sales potential data exclusively for *Restaurant Business* which clearly illustrates the economic advantages of a dedicated home delivery unit versus a freestanding quick-service unit with both eat-in and take-out functions (see table page 255). Space requirements for a dedicated home delivery unit are half of those for an eat-in establishment, while total fixed investment is drastically reduced (for facilities and equipment), and return on investment is two to three times as high for the dedicated unit.

John Jay Hooker, chairman and founder of Hooker Enterprises, Inc.,



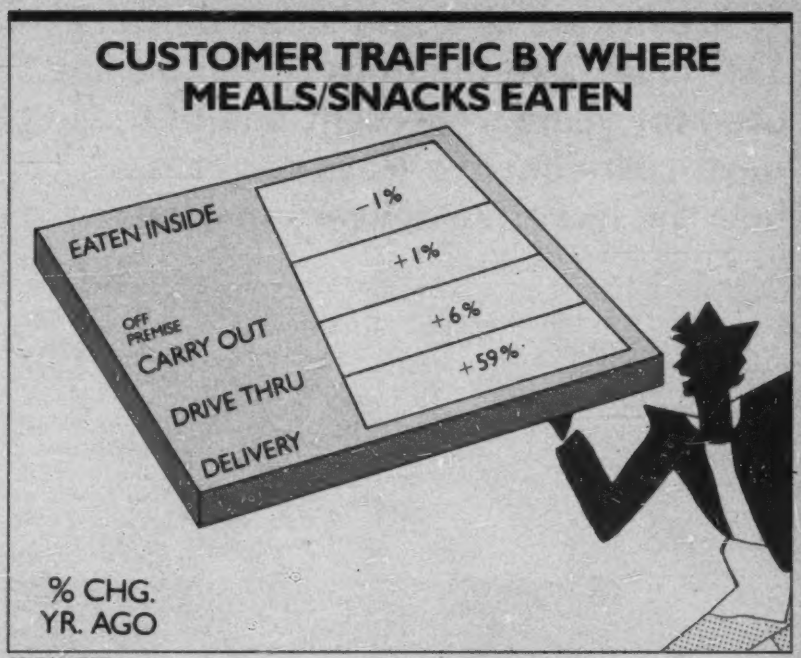
Nashville, TN, has big plans for a dedicated take-out/delivery-only concept. There is currently only one Hooker's Hamburgers unit open in Nashville, but franchisees have signed commitments for more than 500 units. Hooker's plan is to open dedicated mini-units—tiny, 320-sq.-ft. kiosks with double drive-thrus—and sell hamburgers and beverages, as well as convenience store items and videocassette rentals. Plans call for the opening of two units in 1986 and 50 in 1987, with substantial growth after that.

"There is already an enormous amount of 'home delivery' today," observes Hooker, "except that the consumer is doing the delivery himself by taking the product home. I just want to change the messenger."

Hooker cites the cost efficiencies of operating dedicated delivery units as an added factor, because he is also attempting to undercut prices of competitive hamburger chains. A prototype unit with kitchen will cost $100,000. Delivery trucks will cost $10,000, and units will service a three-mile radius.

However, the economic advantages of adding incremental delivery service to an existing eat-in business are not to be discounted. Agribusiness Associates' comparative cost structure for an existing quick-service unit versus one with home delivery added clearly show the potential for increased after-tax profit (see table page 254).

Convito Italiano, with two units in the Chicago area, has added home delivery from its restaurant units, which has boosted sales by approximately 15 percent overall. Approximately 200 items—everything from soups to sandwiches, salads, and gourmet entrees—are available, and average checks for delivery are about $15 to $25, according to Reysa Samuels, store manager. All items are sold by the pound. "The bulk of our deliveries are people who have called in the night before, and we do a lot of catering for home entertaining as well as corporate lunches," says Samuels. "It's a consistent business too: We do a pretty steady volume throughout the week."



SOURCE: CREST

ROLLING INTO BUSINESS. Noble Roman's has begun using radio-dispatched trucks that carry pizza inventory on the trucks in holding ovens, in approximately eight markets, and have found them to be enormously successful, particularly with the college market—a significant audience for pizza delivery. The trucks allow the operation to circumvent its own kitchen, and deliver orders directly using inventory held on the truck.

Noble Roman's trucks contain a patented stainless steel holding oven with humidity and thermostat controls, which provide a static environemnt for handling and holding. (The presence of carefully regulated levels of humidity prevents the product from drying out.) About 1,200 such vehicles are presently in operation around the country, according to Dennis Anderson, vice president, operations, Mobile Systems, Inc. (see accompanying sidebar, page 251). An additional advantage of the trucks is that they are custom designed with the operator's logo, and therefore afford substantial, mobile billboard advertising as they cruise around town.

Though pizza is an obvious product for delivery, other kinds of chains have gotten into the fray. For instance, Burger King, Corp., Miami, FL, has been testing a fleet of 20 "burger busses," mobile delivery units that can be driven to high traffic locations and events.

ETHNIC AT HOME. The enormous recent popularity of Mexican food has helped fuel home delivery ventures in that segment. Mexigo, in New York City, presently has one unit in operation, and three more are planned to open in New York within the coming year. In addition, units are pending in

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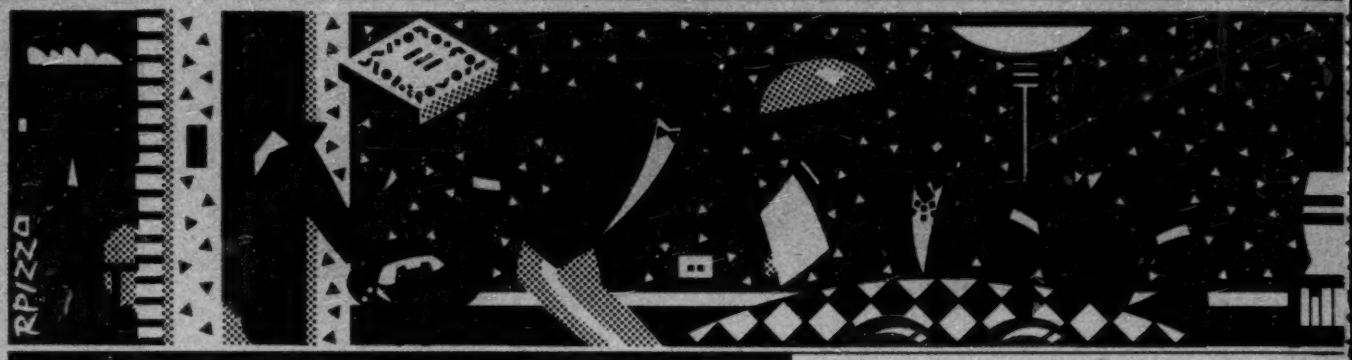
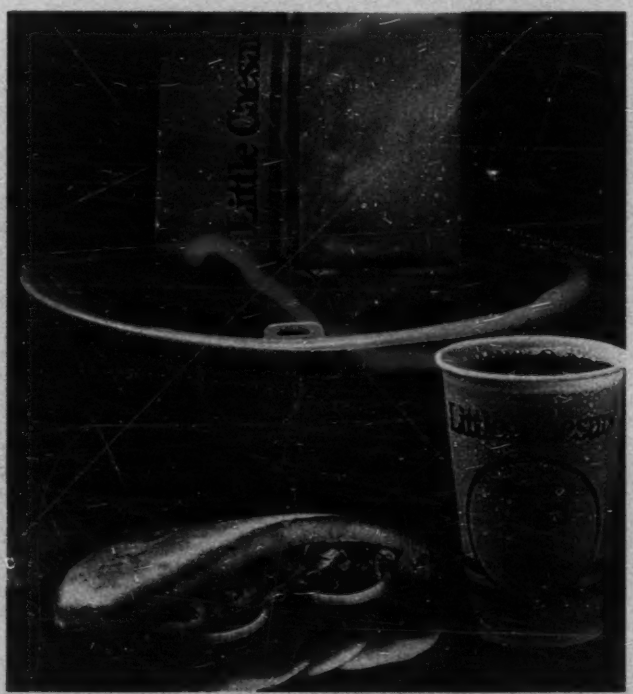


Dedicated or stand-alone delivery units, like the ones Domino's has used for years, represent one of the most cost-effective ways to get into the lucrative delivery market.

Washington, DC, and Florida.

"We think we need to be in dense urban markets to succeed," explains Bruce Galloway, partner in the venture with Barbara Lieu. "Our target market consists of professionals in their mid-thirties and families." The one New York unit, 620 sq. ft. with limited seating, opened in January 1986, and is generating sales of $1,200 per day. Galloway projects sales of $450,000 to $500,000 for the initial unit in the first year, and $2 to $2.5 million annual volume for four units.

McFaddin Ventures, Inc., Houston, known primarily for its club-style restaurants, also hopes to crack the delivery/take-out market via its new Ninfa's division; the company recently acquired franchise rights to the Ninfa's Mexican dinner house concept and has been using the expertise of the founding Laurenzo family to get into a variety of specialty foodservice concepts. Eight Ninfa's Express units, offering both drive-thru and delivery of Mexican food, are slated to open in Austin, TX, this year. The first unit is scheduled to open in July. The concept calls for units of about 1,000 sq. ft., with no seating, and will be developed both as freestanding units and, possibly, in shopping centers. Foods offered will include Mexican-style chicken, fajitas, tacos, etc. "We will eventually go to mid-size cities, and build up our strength for advertising," says Roland Laurenzo, senior vice president, foodservice. "We know we have to appeal to the middle class."



Little Caesar's take-out lunch program is slugged "Lunch is in the bag" and features six options including the Italian sandwich and 16-oz. drink shown right, a small Greek salad with drink, two slices and a drink, and its signature "best pizza in town."

TAKING IT OUT. The potential for building volume from take-out is marked. Chez Melange is a 72-seat restaurant in Redondo Beach, CA, that recently added a gourmet take-out store in an adjacent, 800-sq.-ft. space that became available. Opened in December 1985, the operation is called Chez Allez, and sales have been running at $30,000 a month since it opened. Total restaurant sales are $2.5 million.

"Rather than enlarge the restaurant, which we felt would impair the quality and service, we decided to add on the gourmet business. This way, our growth can be infinite," explains partner Michael Franks. "We figured that our customers need to eat 14 meals a week, so we thought 'Let's try and get them again'."

Chez Allez sells foods at room tem-

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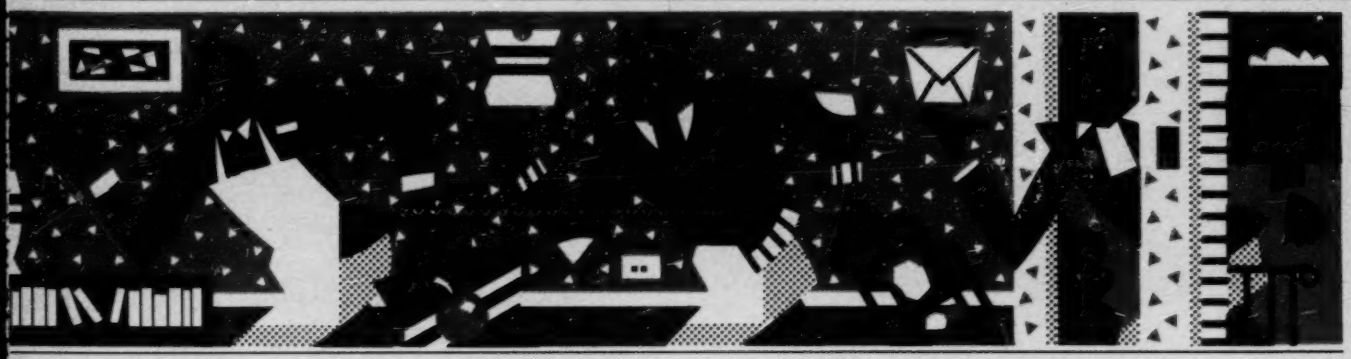
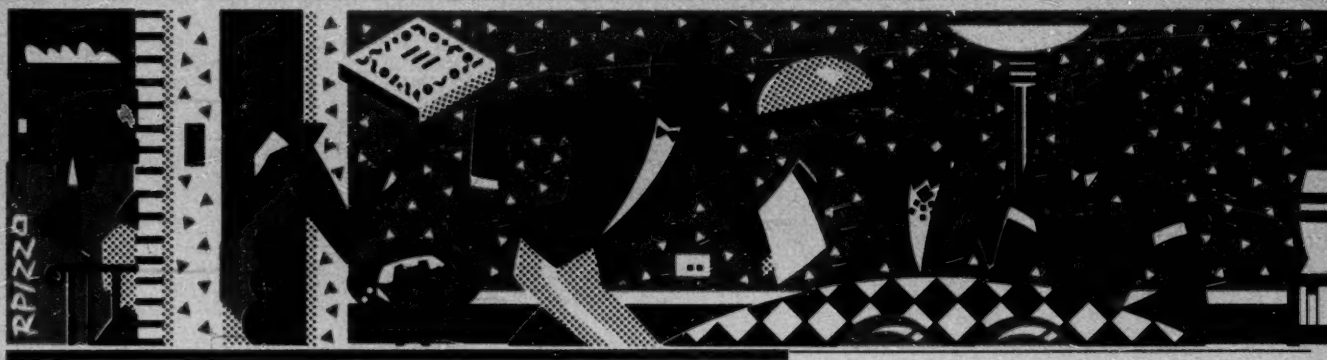


FREQUENCY OF PURCHASING TAKE OUT FOODS AND BEVERAGES AT ALL TYPES OF ESTABLISHMENTS

Demographic Characteristic	Frequent User	Occasional User	Infrequent User	Non-User
SEX				
Male	53.2%	20.9%	9.2%	16.7%
Female	58.3	20.1	8.7	12.9
AGE				
Under 18	51.0%	17.3%	4.1%	26.6%
18-24	87.7	9.6	1.4	1.3
25-34	76.8	17.5	4.0	1.7
35-44	72.2	17.3	4.9	5.6
45-54	53.8	24.3	11.2	10.7
55-64	43.9	30.6	12.2	13.3
65+	30.3	18.8	16.0	34.9
FAMILY COMPOSITION				
Single	57.5%	20.4%	9.0%	13.1%
Married, no children	44.3	20.8	12.1	22.8
Family, youngest child under 6	58.6	17.3	8.7	15.4
6-12	65.7	19.9	3.4	11.0
13-17	65.3	21.5	7.0	6.2
18+	57.6	21.0	9.5	11.9
REGION				
Northeast	54.7%	21.1%	9.1%	15.1%
Midwest	50.3	19.4	9.7	20.6
South	63.7	17.8	6.8	11.7
West	54.0	25.1	10.9	10.0
FEMALE EMPLOYMENT				
Full time	69.2%	17.9%	6.3%	6.6%
Part time	58.1	26.9	8.8	6.2
Not employed	43.9	20.7	10.4	25.0
HOUSEHOLD INCOME				
Under $10,000	48.1%	22.9%	8.4%	20.6%
$10,000-$14,999	57.6	15.8	5.8	20.8
$15,000-$19,999	51.0	29.0	7.0	13.0
$20,000-$24,999	65.2	16.5	7.0	11.3
$25,000-$34,999	57.5	21.0	10.3	11.2
$35,000-$49,999	65.6	14.5	11.3	8.6
$50,000 and over	45.4	26.4	10.9	17.3
HOUSEHOLD SIZE				
One	57.5%	20.4%	9.0%	13.1%
Two	48.3	21.4	11.3	19.0
Three	59.9	20.3	9.4	10.4
Four	62.8	17.6	7.0	12.6
Five or more	60.3	22.3	3.3	14.0
FREQUENCY OF EATING OUT				
4 or more times a month	65.6%	18.1%	6.7%	9.6%
2 or 3 times a month	58.7	19.6	8.5	13.2
Once a month	46.1	26.2	10.0	17.7
Once every other month	28.8	35.6	16.9	18.7
Once every 6 months/once a year	25.0	20.0	23.3	31.7
Never	*	*	*	*
TOTAL RESPONDENTS	56.0%	20.4%	8.9%	14.7%

*Sample size too small for analysis.

SOURCE: GDR/CREST



Understanding the much-discussed Baby Boom generation and its demands and tastes is central to the development and implementation of a take-out or delivery service.

perature to be taken home for reheating, offering both fully prepared entrees, or individual items with instructions on how to prepare them. In order to avoid competition with the restaurant, the take-out shop's menu items are somewhat different, and include things like enchiladas, Cajun meatloaf, fourteen types of salad, and pasta, as well as wines and packaged foods. Franks has found that Chez Allez is less labor-intensive than the restaurant and additional costs to run the operation are low in relation to the total. He adds, "One of our best competitive advantages is personal service, which you can't get in a supermarket."

Contract caterers, realizing they have a captive market at their employee cafeterias, have also begun to address the at-home market by offering dinner items for take-out. ARA Services, Inc., Philadelphia, PA, has been successfully operating its "Dinner Express" program out of about 60 contract locations for the past two years. Bernie Wallerich, vice president, marketing service for the Business Dining division, reports that take-out can account for incremental sales increases of up to 10 to 15 percent per unit; soups, salads, entrees, baked goods and Mexican entrees are among the most popular items and average check for take-out orders is $4 to $5. A total packaging concept has been developed to support the program.

"The biggest problem is where to locate the take-out service," says Wallerich. "It has to be somewhere convenient—you can't expect employees to run back upstairs to the tenth- floor cafeteria when they're rushing to leave at the end of the day, so we try to place units near exits. It's a real sales process, and you have to educate the clients. When employees already may be eating one or two meals daily in the cafeteria, why should they eat a third meal from there? The product has to look beautiful and be appealing in terms of quality and selection. You have to understand what the consumer really wants to buy."

The company's Araserve division, meanwhile, is courting the college market through its Itza Pizza mobile cart/delivery program.

UPSCALE. At the more upscale end of the take-out market, restaurants can realize substantial profits by capitalizing on take-out business, and many report that they see sales figures that do not detract from on-premise restaurant sales. John B. Polcari & Sons, Boston, is both a restaurant and groceria; combined sales for both are projected at $2 million for this year. About 20 percent of the operation's volume is generated by retail and take-out sales, with approximately 70 percent of take-out sales at dinner. The groceria also does limited local delivery.

The groceria offers fully prepared take-out dinners, priced $7.95-10.95; the selection includes such items as yellowtail tuna stuffed with smoked gouda, fettucine with lobster and cilantro pesto, blackened mako shark, and mesquite-grilled lobster sausage. Average check is $7.

"A good restaurateur will listen to the consumer," explains Paul Kruzel, manager, of Polcari's appeal. "We're located in an area that has undergone tremendous renovation, with luxury condo units. Everyone has gone after the Yuppie market, and that's a big audience for us, too."

Advertising is a critical element in a

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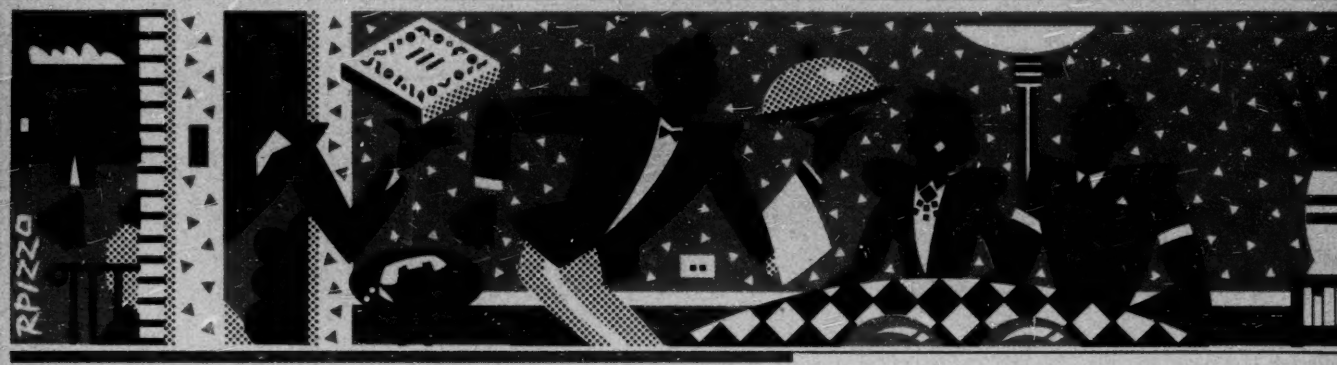

Supermarkets and convenience stores are also attempting to tap the market with gourmet prepared foods and by stocking shelves with high quality frozen dinners.

successful take-out or home delivery operation, a point often overlooked by many operators. Mailers and flyers can be compiled from records of customers' orders, and delivery trucks often carry bold advertising signage, but a restaurant that adds on a take-out or delivery business must still publicize both elements of the business to remain successful: Neither service is truly top-of-the-mind for consumers at this stage.

"Consumers are open to a wide variety of delivered items, for instance," says William Hale, "but right now, if it's not pizza, they don't expect it to be delivered. You have to publicize, and there's a lot being done with computers and home delivery to capture names and addresses for direct marketing."

Itza Pizza represents another one of ARA's attempts to tap into the at-home market, in this case the college market served by the company's Araserve division. Itza Pizza is served off a mobile cart or delivered, and has boosted sales significantly on campus.

WRAPPING IT UP. Packaging is also one of the integral challenges of any take-out/home delivery business, both in terms of maintaining quality levels during transport and helping to establish a distinctive concept. Herb Sedler, president, Paper Enterprises, Inc./ Elaine Products, New York City, advises that for the delivery of hot items, "the delivery system has to get it there hot, not the packaging. Traditionally, packaging is about six percent of a total budget, but can vary according to needs."

Sedler is emphatic about the need for upscale packaging for gourmet units. "The gourmet market is wide open. It's disgraceful for a high-end gourmet store to use the same packaging as a fast food unit." One of the most important things to remember when developing packaging, adds Sedler, is to establish a strong theme, and maintain it graphically throughout all packaging.

UNDERSTAND THE MARKET. The strength of any take-out and home delivery business is most certainly based on understanding the operational and logistical elements of food preparation, delivery systems, customer satisfaction, promotion and advertising and the enormous potential in this growing market. The potential for profits, in lower overhead and fixed costs, make it enormously appealing, but foodservice operators should understand their particular niche in the vast market before attempting to satisfy the growing demands of the at-home market.

For instance, it is important to understand just what role the supermarket plays in the competitive picture.

In the quest to become, as one industry observer puts it, "the queen of one-

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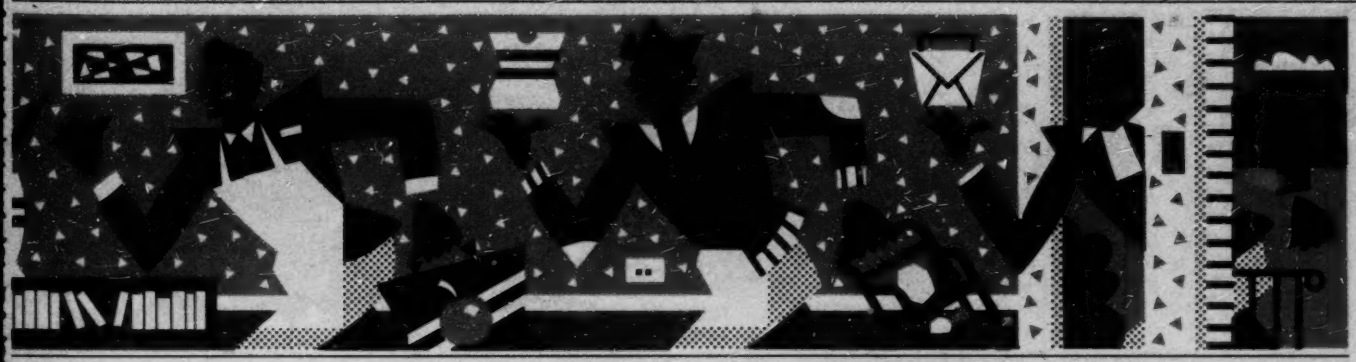


ESTABLISHMENT WHERE TAKE-OUT FOOD WAS PURCHASED-BY REGION+

	TOTAL 1985 REGION			
	EAST %	MID-WEST %	SOUTH %	WEST %
Fast food restaurant	48	63	67	51
Family restaurant	7	8	6	5
Supermarket/grocery store deli	5	6	5	8
Take-out food store	6	8	4	10
Deli (not in supermarket)	11	2	4	4
Chinese restaurant	9	2	2	3
Convenience store	2	2	4	2
Mexican restaurant	1	2	1	6
Cafeteria	1	1	1	1

+ Establishments named by fewer than one percent are omitted.

ESTABLISHMENT WHERE TAKE-OUT FOOD WAS PURCHASED-BY DAY OF WEEK+

	Total 1985							
	Total Who Purchased Take-Out Food %	Day Purchased M %	T %	W %	T %	F %	S %	S %
Fast food restaurant	58	63	55	58	57	56	55	62
Family restaurant	7	4	5	9	6	10	5	7
Supermarket/grocery store deli	6	5	5	6	4	6	8	3
Take-out food store	6	5	3	6	6	7	10	7
Deli (not in supermarket)	5	5	10	5	5	4	6	4
Chinese restaurant	4	4	2	2	3	4	4	7
Convenience store	3	3	5	2	4	3	1	2
Mexican restaurant	2	*	1	0	3	3	2	4
Cafeteria	1	1	1	1	1	2	1	0

*Less than one-half of one percent.
+ Establishments named by fewer than one percent are omitted.

SOURCE: Gallup.

One of the biggest challenges to a delivery system is that of speed; customers are just as interested in quick service and convenience as they are in high quality food.

stop shopping," the 7-Eleven convenience store chain (a 9,000-plus unit holding of Dallas-based Southland Corp.) has begun nationwide expansion of a videocassette rental program that is projected to bring the service to 3,000 units nationwide by the end of 1986. With tapes renting at approximately 99 cents, the service will seriously undercut prices charged in dedicated rental outlets. With ambitious foodservice plans already in place, including a recent agreement with Rocky Mount, NC-based Hardee's to offer the fast food chain's products in 7-Elevens, the convenience store chain is positioning itself to take advantage of the stay-at-home trends.

And supermarkets, also embarked on the same one-stop shopping quest, are beefing up in-store deli and take-out outlets. Giant Supermarkets, based in Washington, DC, has 138 stores and big plans. Two of its units offer gourmet and prepared meals for take-out in a test that will probably be expanded. "We're highly service-oriented, and we like to have a lot of departments under one roof," says Barry Scher, director of Public Affairs.

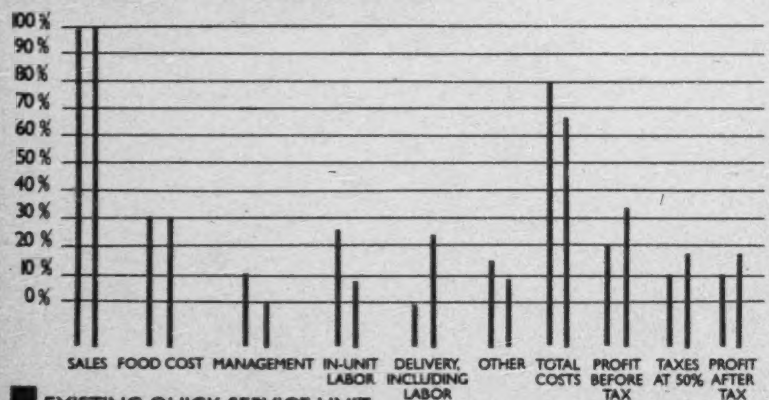
Supermarkets are also reaping the fruits of steadily growing sales of frozen food entrees, aided by steadily increasing sales of microwave ovens. Actually, gourmet frozen food entrees are demographically aimed at much of the same at-home market restaurateurs are hoping to capture.

According to Selling Areas Marketing, Inc. (SAMI), a New York City-based market research firm, in 1985, frozen food gourmet entrees totalled $1.045 million in sales, up approximately 25 percent from $831 million in 1984. Quality frozen food entrees, such as Le Menu and Classic Light, account for 45 percent of all frozen food dinners, and represented $439 million in sales last year.

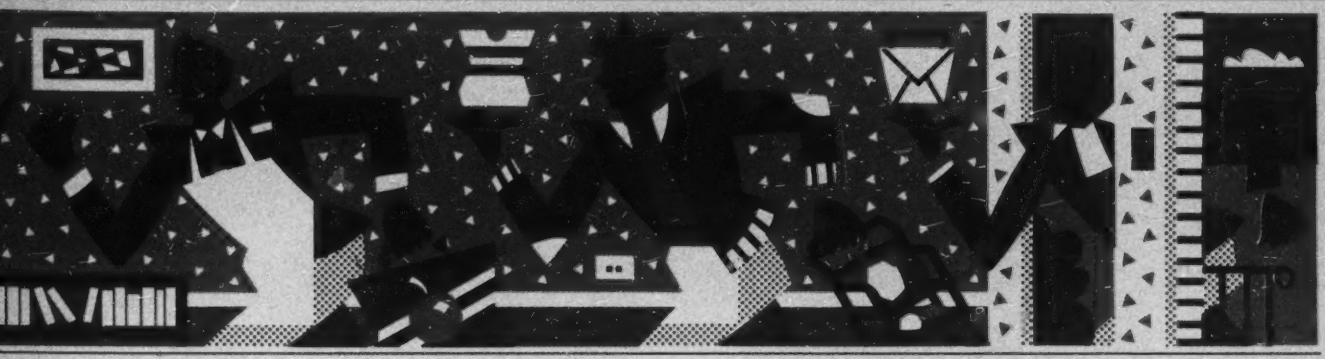
White Castle has begun capitalizing on the strength of frozen prepared food market by expanding its own business through that avenue. Eight-packs of frozen White Castle burgers are now being tested in supermarkets in Indianapolis, IN, and Denver, CO, at a cost of under $4 per pack.

Initially, according to Gail Turley, director of public affairs, the frozen burgers were offered as a response to White Castle "burger bootleggers," who were buying burgers at retail prices and then taking them elsewhere for resale. "We were hoping to discour-

COMPARATIVE COST STRUCTURE: EXISTING QUICK-SERVICE UNIT AND INCREMENTAL HOME DELIVERY FROM EXISTING QUICK-SERVICE UNIT



SOURCE: AGRIBUSINESS ASSOCIATES, INC. FOODSERVICE STRATEGY GROUP



age this, and in the process, set up formal tests for supermarket sales of frozen burgers." The company plans to set up an experimental factory to produce the burgers for retail this fall.

THE DEMOGRAPHICS. According to CREST data, take-out and off-premise dining were responsible for 40 percent of total customer traffic in restaurants in 1985, representing a market of $25 to $30 billion. Of those customers purchasing food at a table service restaurant, a full 60 percent ate the take-out at home, followed by 13 percent who ate in the car, 10 percent who ate at work, and 17 percent who ate in 'other places.'

Moreover, according to CREST, and most important for foodservice operators, take-out and home delivery represent the greatest growth opportunity for foodservice operators. For all restaurants in 1985, 60 percent of meals were eaten on-premise, a one percent decline from 1985; 27 percent of all meals were carry-out, a one percent increase; drive-thru accounted for 11 percent of all meal purchases, a six percent increase; and delivery (to the home or other location) represented only two percent of sales, but that was a 59 percent increase over 1984.

The big growth has been in dinner sales. In 1985, according to the National Restaurant Association (NRA), while sales of lunch eaten inside restaurants rose two percent, sales of take-out lunches jumped ten percent. For dinner, take-out sales rose 16 percent, while eat-in sales were flat.

A look at who take-out customers are is most revealing (see chart page 249). According to an NRA study, the most frequent take-out customers include women, 18 to 34 year olds, singles, families with teenagers, households where the female head is employed, and households with incomes from $20,000 to $50,000.

Two important demographic trends promise to swell these numbers: the growth of the two-income family—within the 70 million-strong Baby Boom generation, more than half of all married couples are dual wage-earning—and the simultaneous trend of later marriage, which has resulted in more single-person households.

COMPARATIVE INVESTMENT AND SALES POTENTIAL FOR STAND-ALONE QUICK-SERVICE RESTAURANT AND DEDICATED HOME DELIVERY OPERATION

	STAND-ALONE UNIT FOR EAT-IN AND TAKEOUT	DEDICATED HOME DELIVERY UNIT
SPACE REQUIREMENT *(SQ. FT.)*	2000-2500	1000-1200
TOTAL FIXED INVESTMENT (INCLUDES EQUIPMENT, FACILITIES/ LEASEHOLD IMPROVEMENTS)	$600,000 TO $1,200,000	$100,000 TO $150,000
SALES POTENTIAL	$600,000 TO $1,200,000	$500,000 UP
FIXED CAPITAL TURNOVER ($ OF SALES PER $ OF FIXED INVESTMENT)	$1.00 TO $1.50	$3.33 TO $5.00 UP

SOURCE: AGRIBUSINESS ASSOCIATES, INC. FOODSERVICE STRATEGY GROUP

The NRA study also yields this revealing information about the market for food consumed off-premise:

- More than half (56 percent) purchase food to go more than twice a month.
- Those who are less likely to purchase take-out meals include: senior citizens, married couples with no children, households where the female head is not employed, and households with incomes under $15,000.
- Lunch is a popular take-out meal. Over half the take-out consumers interviewed reported they purchased foods and beverages for lunch at least twice a month; only 12 percent said they never do.
- Nearly everyone likes the advantage of a take-out dinner. Most of those who do buy take-out for dinner do so frequently, with 45 percent reporting they purchase take-out for dinner two or more times a month.
- Nearly half of those interviewed said they were purchasing more take-out meals than they did three years ago.
- Most people appear to be satisfied with take-out service at the nation's restaurants. Specifically, they are satisfied with the packaging, the quality of food and the variety of food offerings.
- Consumers prefer take-out foods and beverages purchased at restaurants and fast food places to those purchased at grocery and convenience stores. (This is so despite the fact that grocery, convenience and deli stores combined account for 17 percent of total take-out sales, according to Gallup.)

The heart of the at-home matter, according to George Rice, lies in understanding the much-talked-about baby boom generation. "They're 18 to 40 years old, and they're getting married and having their first child. They're buying homes, cars, VCRs, and becoming more conservative. If they want to go out, babysitting costs $2 an hour, and there are limited places to comfortably take a young child. The home is becoming a more desirable place to be, and they're ready to enjoy family life."

BUDGETS: A SURVEY OF MULTI-UNIT OPERATIONS

Insight into the budgeting practices of top foodservice companies will help you to reconsider this valuable financial and operational tool.

by Raymond Schmidgall and Jack Ninemeier

Most restaurateurs are well aware of the advantages to operating budgets. These financial tools help to establish profit plans and help the foodservice operator "keep on track."

Multi-unit firms predominate in the foodservice industry; more than 50 percent of all revenues generated by the industry are the result of multi-unit (chain) business. In spite of this, there is little published information.

A SURVEY. Financial executives—generally corporate controllers—from 31 of the 70 largest commercial foodservice chains in the United States were surveyed.

Table 1 shows basic information about the foodservice firms whose budgeting practices are reviewed.

Most companies had both company- and franchise-operated units. (The smallest organization had three units; the largest had 2,100 units.)

Sales volumes were large; sales exceeded $500 million in eight company-operated and seven franchise-operated companies; the lowest sales volume was $1.8 million and the largest company had sales in excess of $1 billion.

Since the budgeting process involves communication and coordination activities throughout the organization, the type of management structure and the number of layers of management structure in the companies studied was an important consideration.

Tables 2 and 3 show, respectively, a typical organizational structure of a multi-unit foodservice firm and the number of management layers in the companies analyzed in this report.

The organizational structure is typically complex; all but two of the responding companies had four or more organizational levels. The number of organizational levels appeared to be affected by the number of units; larger companies required more intermediate layers in their organizational structure.

THE DEVELOPMENT PROCESS. Budgets for multi-unit chains can be developed in two basic ways. First, separate budgets can be developed by each unit manager and the "numbers" can then be "rolled up" through successive organizational layers to the corporate level. This approach is typically called "bottom up" budgeting. Alternatively, budgets can be developed at the corporate or other high organizational levels and passed down through the organization, with each level becoming more responsible for a specific segment of the budget. This approach is commonly called "top down" budgeting.

Which of the above approaches is used in commercial foodservice chains? Most companies (18 of the 31 firms) use a "bottom up" approach. Fewer companies (8 of 31) use a "top down" approach.

One corporation developed a separate budget under both methods; a "compromise" budget resulted.

What factors prompt the more frequent use of the "bottom up" budgeting method? Among the reasons cited:

A need to increase feeling of unit-level "ownership" in the budget. The manager was likely to be more committed to the budget if he/she contributed to its development. Bonus plans are often tied to budgets; again lower level input helps the manager understand that budget goals are feasible.

An ability to recognize specific problems which affected lower organizational levels.

Organizations using the "top down" budgeting process do so for the following reasons: The concern that the total of individual unit budgets would not meet corporate expectations.

Unit managers are not aware of plans for new products to be introduced during the budget year.

Unit managers are not aware of

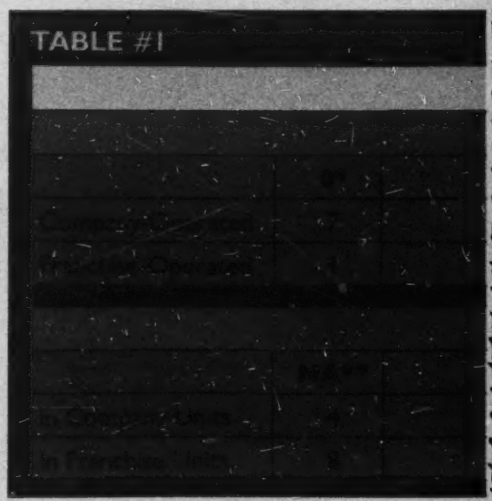


TABLE #2

TYPICAL ORGANIZATIONAL STRUCTURE OF RESTAURANT CHAINS

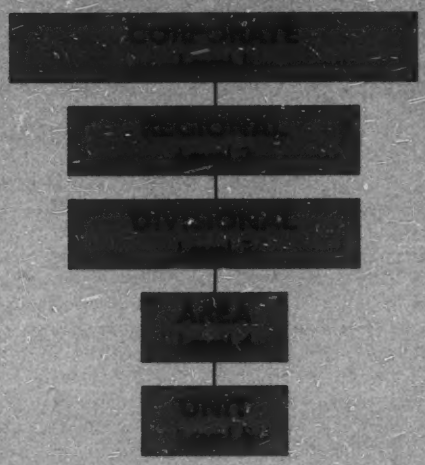
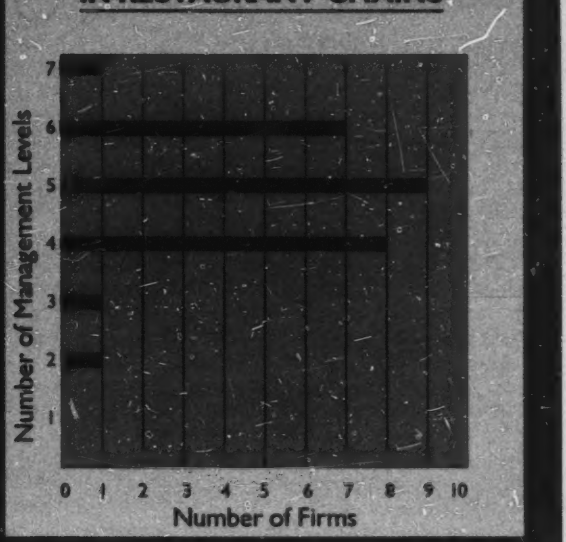


TABLE #3

NUMBER OF MANAGEMENT LEVELS IN RESTAURANT CHAINS



planned price increases.

When unit managers develop budgets independently of other units there may be inconsistencies in assumptions.

Unit managers may not be aware of marketing/advertising plans.

Unit managers may not be aware of business expansion plans.

How important is it for unit managers to provide input to financial plans which impact their units? The current emphasis on participative management styles suggests that this concern is a real one in many multi-unit companies. However, the fact that some unit level managers do not have the broad picture, which is required for company-wide planning, is also evident in other companies.

Not surprisingly, a tentative financial goal (such as desired net income) is established prior to developing the budget in the majority (23 of 31) of the organizations studied. In most (21 of 23 companies) this goal is established at the highest organizational level.

How do multi-unit organizations develop sales estimates? Among the factors used are:

- Historical operating information.
- Impact of expansion.
- Economic indicators generated and/or interpreted by lower levels.
- Impact of menu changes.
- Operating changes suggested by corporate level managers.
- Advertising/planned promotions.
- National economic information.

Logically, each of the companies considered historical operating information as sales estimates were established. It is of interest, however, that more attention is given to economic indicators supplied by lower level management than to national level economic concerns (25 companies considered local economic indicators; only 20 companies considered national level economic information) as budgets are developed. This seems to support the frequency with which the "bottom up" versus "top down" approach is used.

LONG-RANGE PLANS. Do multi-unit foodservice organizations utilize long-range budgeting? Twenty-three of the 31 firms surveyed responded that they do. One company develops budget projections for a two-year period. Three companies prepared budgets for three years. Sixteen firms developed operating budgets for a four-year span. Three companies used five- or six-year budget plans.

Operating budgets typically become less specific as the time frame increases. How much lead time is required to put together the operating budget in multi-unit firms? The companies in the study utilize budget calendars ranging from one to six or more months. Most (25 firms) require four months or more lead time to prepare operating budgets.

Budget reforecasting involves a review of actual operating data as the budget period evolves in order to revise the operating budget for the re-

continued on page 356

SUBJECTS IN STUDY

Number of Units in Company				
1-100	101-300	301-600	601-1,000	Over 1,000
8	9	4	6	3
3	6	1	4	6

Company Annual Sales Volume (In Millions)			
$1-100	$101-500	Over $500	Not applicable
6	2	8	1
2	7	7	7

*One company was comprised of only franchisee-operated units; 7 organizations had no franchise units; two companies did not respond to the question about number of franchised units.

**No answer

Multi-unit companies need more time to develop budgets.

BUDGET *continued from page 355*
mainder of the year. Typically, the income statement is used as the source of actual income/cost information. As the year evolves, budgets developed before the start of the current year are updated based upon actual operating results. Managers can then compare subsequent operating results with the original and/or reforecasted operating budgets. Since the budget development process takes a long time and because computerized methods are available to reforecast, the process appears to be a relevant activity in multi-unit firms. Most (23 firms) reforecast budgets as the fiscal year evolves. Reforecasting begins less than three months into the budget year for 14 of the 23 firms. Reforecasting is generally undertaken by or near the corporate organizational level (this was the case in 14 of the 23 firms who addressed this concern). Reforecasting is done on a monthly basis (by 10 companies); on a quarterly basis (by six companies); when it appears necessary for specific units (by five companies); or on a bimonthly basis (by two).

When reforecasting is done the operating budget is typically revised for the remainder of the fiscal year. Reforecasted budget information can be used as a benchmark against which to measure actual performance, to review pricing plans and/or to generate new projections for year end results.

One basic purpose of an operating budget involves the development of benchmark financial plans against which actual operating information can be compared. Most (28 of 31 firms) indicated that the operating budget was used for operational monitoring purposes in the individual units. However, fewer (22 of 31 chains) indicated that unit managers were held responsible only for operating costs which were within their control. Actual income and expense information is compared with the original budget in many companies (24 of 31 firms). Surprisingly, however, actual operating information is compared with the reforecasted budget in only 17 of the 23 companies which routinely reforecast the budget.

BUDGETED AND ACTUAL COSTS. Management and financial staff frequently compare budgeted and actual cost information in order to determine whether corrective action to reduce expenses is necessary.

A relatively small amount of variance is allowed. For example, as shown in Table 4 (Variance Levels for Prime Costs) the majority of organizations take corrective action when the actual food, beverage, and labor costs exceed the budgeted cost of these expense categories by more than two percent. Table 4 shows that 20 firms require corrective action when actual food costs exceed budgeted food costs by more than two percent; 11 companies take corrective action when beverage variances exceed two percent; and 20 organizations allow a two percent variance for labor costs.

The process of comparing budgeted and/or reforecasted cost to actual costs as reported on the income statement is done on a monthly basis in the majority (25 of the 31 firms).

There is strong involvement of both the unit and organizational level immediately above the unit in the budget development process. (For example, 19 of 31 organizations involved these levels in the budget analysis process. Likewise, 15 chains provide for budget analysis responsibilities at higher organizational levels.)

Surprisingly, relatively few (13 of 31) organizations use unit and/or the level above unit personnel to implement corrective actions. While it is interesting to note that top levels of large chains with many operating units are involved in implementing corrective action this does suggest that multi-unit managers adhere to a basic management principle. Responsibility cannot be delegated.

SINGLE- VS. MULTI-UNIT BUDGETING. A number of differences between procedures used to budget in single- and multi-unit foodservice operations were pointed up by the respondents in this study. For example, in the multi-unit organization: There is a greater need for coordination. The volume of information to be precessed is greater. More sophisticated—and frequently computerized—procedures must be used. The amount of time required to develop the budget is likely to be greater. Procedures to allocate costs between organizational levels are unique. The extent of management attention to the budget process is likely to be greater. Many budget policies are generated externally to the unit.

Readers should note that the information presented in this report is based upon information supplied by only 31 organizations; it cannot represent a conclusive definition of budgeting practices. However, it is a beginning and managers in multi-unit restaurants should recognize both the unique aspects of budgeting in their organizations and, as well, the fact that the basic principles do not differ from their single-unit counterparts.

Raymond Schmidgall, Ph.D., CPA, and Jack Ninemeier, Ph.D., are associate professors for the School of Hotel, Restaurant and Institutional Mangement at Michigan State University, East Lansing, MI. *Their research was funded in part by the PepsiCo Foundation.*

TABLE #4

VARIANCE LEVELS FOR COSTS

Percent Variance between Budget and Actual Costs

$ Cost	Under 1%	1-2%	2-3%	3-4%	4-5%	Over 5%	No Set Amount
Food	10	10	4	1	1		4
Beverage	7	2	1	1	1		2
Labor	10	7	4		2		2